

## HOW MULTINATIONAL COMPANIES CAN ROLL BACK THIRD-WORLD POVERTY

By Lewis A. Engman

**Editor's Preview:** Democratic capitalism is moral, self-energizing, and wonderfully effective in creating wealth. Authoritarian economic systems impoverish nations by stifling incentives, choking innovation, and eroding personal freedom.

Why, then, Lewis Engman asks, do so many Third-World countries choose authoritarianism anyway? Frustration, impatience, and resentment at relative inequality between themselves and the developed countries, are his answers.

Multinational corporations, given hospitable business conditions, have shown that they can accelerate a poor country's transition to better living standards by democratic capitalist transplants, like sod patches transforming barren ground. But expropriations, punitive regulations, and the investment-detering policies of U.N. bodies too often kill the transplants, to the loss of all.

Can the Third World really prefer an equilibrium of poverty to a share in the dynamically increasing, if unequal, wealth which free institutions and outside private investment can bring?

Democratic capitalism, for all its complications and imperfections, is the Third World's greatest hope for sustainable economic development. The multinational corporation is perhaps the most effective means of securing the benefits of democratic capitalism for Third-World countries. Those are the two propositions I want to establish.

Simply defined, democratic capitalism is an economic system that:

- respects private property, including intellectual property;
- welcomes all competitors;
- encourages the widest possible range of consumer choice;
- recognizes that firms, like individuals, act in their own



best interest in the competitive economic process, and that the success of each participant *enriches* rather than impoverishes all others; and  
 —is open across borders, reflecting the reality that ours is truly a world economy.

The genius of democratic capitalism is that it is self-energizing. The system is very good at translating public will into public benefits through the agency of private interests. The freely given labors of individuals seeking to better themselves are harnessed through the mechanism of the competitive marketplace and efficiently deployed in the production of those goods and services to which society attaches greatest value.

Some have called this system immoral because it is propelled forward by greed. But the openly expressed desire to improve one's circumstances is what economic development is all about. And in a free-market economy, the only way for the individual to improve his circumstances is by providing what his fellow citizens want.

If acting morally means acting in the interests of one's fellow citizens, then democratic capitalism must be the most moral of systems.

In addition to being moral, the system offers another plus: it works. During the past century, democratic capitalism has generated more development, more innovation, and more wealth than all other systems combined have produced in the history of mankind.

Authoritarian economic systems, by contrast, work far less well. Motivation is a problem. Workers whose wages are set by the state have little incentive to put forth superior effort. This is nowhere more evident than in the Soviet Union, where agricultural productivity on the private plots citizens are permitted to farm in their spare time is 30 times the productivity of the collective farms.

Innovation, too, is a problem in state-run economies. Individuals whose welfare is not tied to the economic success of the enterprises in which they work are not likely to look for ways to ensure that success. Imagination and invention are the work of a relative few. New ideas are subject to approval by the state. The consumer has little voice in determining the rate or direction of innovation. He stands in line and counts himself lucky if the shelf is not bare.

One need only contrast the vastly different living standards of Eastern and Western Europe, and recall that a generation ago the differences were imperceptible, to

understand the long-term economic price of state authoritarianism.

Even more important, the state-run economy is wholly incompatible with personal freedom and human dignity. (And in the long run, for that reason, it can only be a cause of, rather than a cure for, political instability.) The state which sets production priorities cannot permit its citizens to work where they want, or at what they want. The state must fill the jobs available. If a citizen wishes to be an engineer, but the state needs an assembly line worker, the citizen is out of luck. If he wishes to work in one city, but the state needs him somewhere else, he is again out of luck. People in such a system have scarcely any personal freedoms that cannot be peremptorily revoked by the state to meet its planning objectives.

### Why Do They Choose Failure?

State authoritarianism may be orderly, yes. It may be less messy than the democratic capitalist alternative. But state authoritarianism is hardly the role model for the leaders of developing nations concerned about long-term development and political stability. If there were doubt about this, it should have been dispelled by the recent decision of China's Communist government to abandon many state controls in favor of market solutions.

The choice between the two systems would seem to be so clear cut, one wonders why any developing nation opts for an economic system that so clearly has been a failure. My answer is in one word: *frustration*.

Some countries, confronted with political and economic chaos, struggling with illiterate populations, find authoritarian systems seductive because such systems promise order, permit central control, and empower the state to move people and resources at will. They eliminate the messy problem of securing support from scattered and heterogeneous electorates. They *appear* to be a fast and simple way to eliminate managerial impediments, mobilize resources, and get down to the business of economic development.

Other countries stumble into authoritarianism piecemeal, scarcely aware of what they are doing. This is not hard to understand. The economic alternatives often seem less clearly defined in practice than in theory. They do not diverge as two roads from a fork, but tend to run parallel courses and to be clearly delineated only to those who firmly grasp the differing principles that distinguish one from another.

Nations whose leaders do not firmly grasp those principles very easily wander off course, nominally claiming adherence to the democratic capitalist philosophy, but bit-by-bit adopting the policies of economic authoritarianism. They may, for instance, decide—as many have—that economic growth can be accelerated by seizing the material or intellectual property of private enterprises from the developed nations. This is self-defeating. How can countries espouse market incentives and private

### Constructive Alternatives for Third World Explored at Seminar by Engman and Other Speakers

Washington attorney Lewis Engman was one of 13 speakers who addressed a seminar of the Center for Constructive Alternatives on the overall topic, "Economic and Political Pluralism in the Third World," at Hillsdale College in November 1984.

Other position papers were given by Raymond Gastil of Freedom House, Jonathon Kwitny of *The Wall Street Journal*, AID official Richard Derham, Free Zones expert Mark Frazier, Dow vice president Enrique Falla, Don Decker of Dana Corporation, James Wilkie of UCLA, Melvyn Krauss of NYU, Keith Barlow of the Army War College, Kendall Brown of Hillsdale College, Austrian scholar Erik von Kuehnelt-Leddihn, and Nancy Truitt of the Fund for Multinational Management and Education.

Mr. Engman was formerly chairman of the Federal Trade Commission, president of the Pharmaceutical Manufacturers Association, and assistant director of the White House Domestic Council. He holds an economics degree from Michigan, a law degree from Harvard, and studied at the London School of Economics.

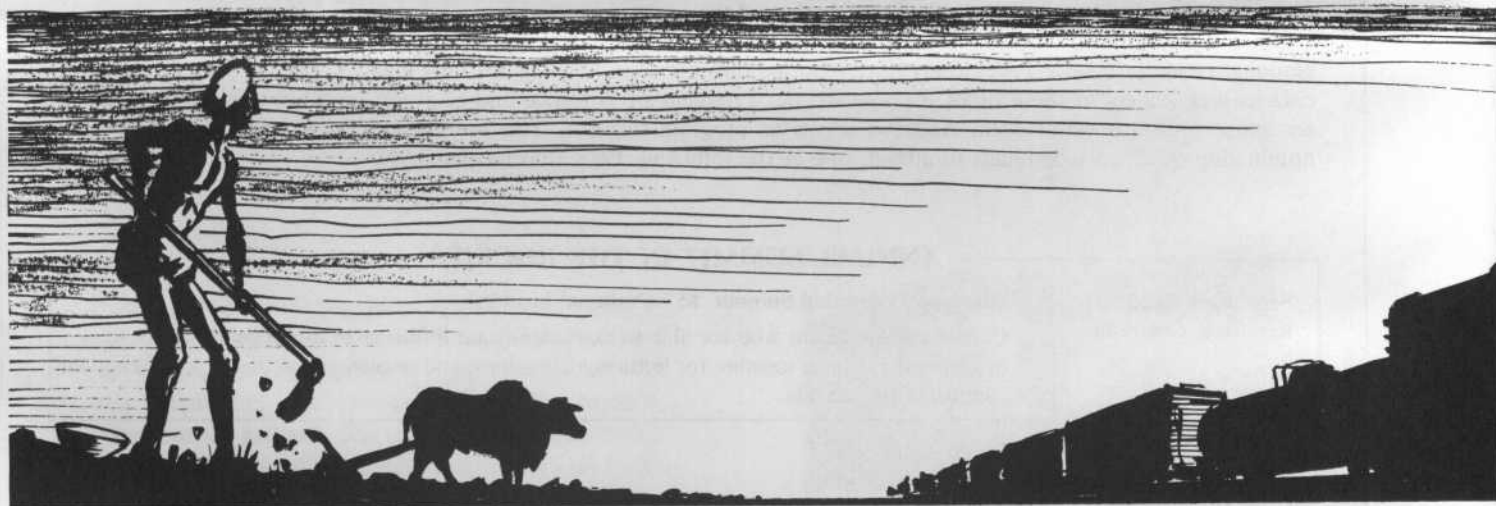
property because they are the proven ingredients of rapid development, then turn around and destroy market incentives by expropriating the private property they have created? They can't; at least not for long.

The result is a mongrel economy, possessed of capitalism's hurly-burly disorder, but shorn of its incentives and market disciplines. Where this occurs, disillusionment results, and democratic capitalism very often takes the rap.

If frustration often lies at the root of the decisions that lead to authoritarian economic policies, what lies at the root of that frustration? I suggest that it is *inequality*—a condition for which democratic capitalism makes no apologies—and a preoccupation with *relative* rather than *absolute* measures of progress.

their standards of living: huts to apartment blocks, buckets to running water. But because they have simultaneously been exposed to standards of living in more developed countries, these gains are little appreciated. Here, too, one hears calls for redistribution of income.

Those who demand authoritarian income redistribution fail to comprehend the source of the modest wealth they are already beginning to enjoy. They view themselves as dray horses hauling carriages for the rich. In fact, they are more accurately occupants of the caboose on a train being pulled out of poverty by the engine of private capital. The countries in the rear of the train have as great a stake in its velocity as do those fortunate or gifted enough to be at its front. They may wish to move up



### The Frustration of Inequality

In terms of human capital and economic infrastructure, most developing countries are many decades behind the West. They cannot expect to eliminate this gap in a few years. But it is folly to equate lingering relative disadvantage with failure. The meaningful measure of economic progress is change in absolute terms.

There are today, even in this country, people who do not accept this, people who count themselves poor because they are forced to live with a black and white TV, a six-year-old car and a weekly rent obligation. By the standards of their parents or their contemporary counterparts elsewhere in the world they are rich. But they feel poor because they measure material well-being not against past circumstances but against the circumstances of others.

In some, the perception that they are less well-off than others kindles the fire of ambition and enterprise. In others, it breeds resentment and the demand that wealth be forcibly transferred from others to themselves.

The same sentiments are heard in developing nations. Many of them have experienced vast improvement in

through that train. They may, reasonably, try to shorten the train by improving their lot relative to those ahead of them. But if they fall into the trap of supposing that their circumstances will be improved by appropriating power from the engine, they are merely condemning themselves to the conditions they seek to escape.

The only equality promised by democratic capitalism is the equality of opportunity. For that our forefathers in this country fought and died. But nowhere in the orthodoxy of democratic capitalism is equality of circumstances promised. Indeed, the two concepts are philosophically contradictory.

What democratic capitalism promises is that each individual be free to improve his circumstances to the best of his ability. And the record shows that individuals, given this freedom, will advance their circumstances more rapidly and farther than they will under any other system.

Might not there be some other system in which rapid growth and development are more compatible with equality of wealth? There might be. *But no one has found it yet.*

Let's look now at the way this frustration at inequality,



and the resulting efforts at redistributive solutions, tend to operate most harshly against the one institution best equipped to narrow the gap between "haves" and "have nots" in the Third World—namely, the multinational firm.

### **Transplanting Democratic Capitalism**

As we know, the smooth operation of democratic capitalism requires certain preconditions that cannot be created overnight. It depends on values such as respect for individual rights and private property, and on basic economic infrastructures for capital formation, distribution of goods, and dissemination of market information.

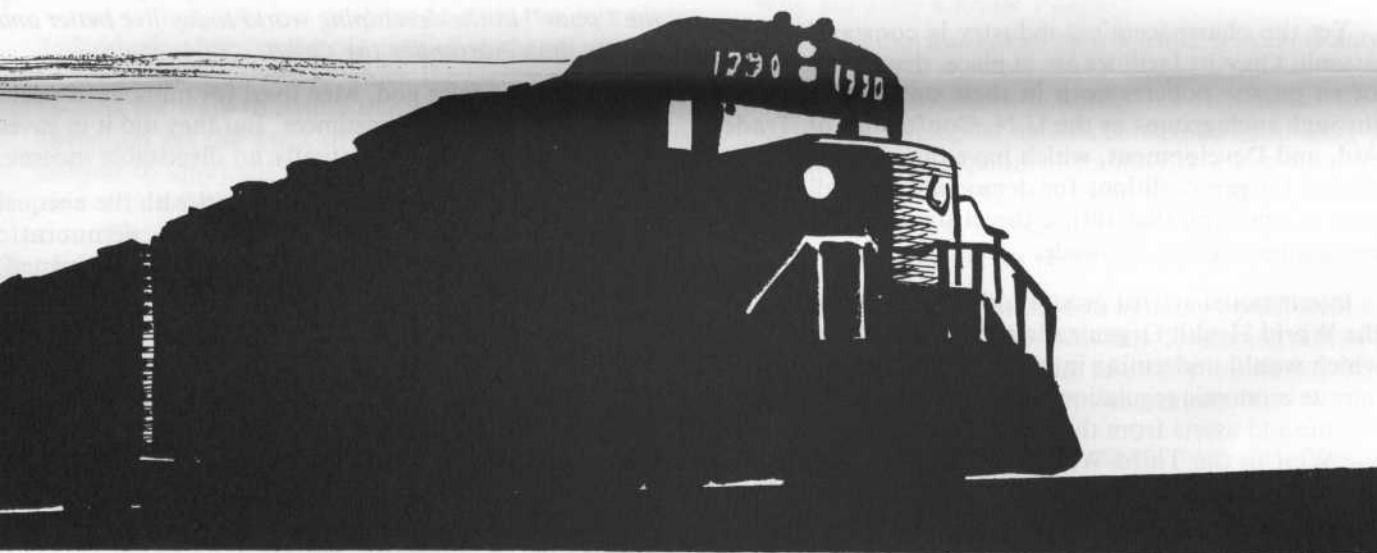
These preconditions took generations to be satisfied in the developed nations where democratic capitalism is the reigning orthodoxy. And they will take decades to

of democratic capitalism, require the hospitality of the host. Sod laid upon concrete quickly dries and withers. Multinational corporations deprived of the freedoms and incentives that energize their activities cease to confer benefits, and eventually withdraw whence they came.

In much of the Third World today, the multinational corporation often encounters not hospitality but hostility. This hostility, taking the form of punitive regulations, is disastrously counter-productive.

The most effective, and potentially by far the largest form of assistance for the developing world is private-sector direct investment.

No other form of assistance can compare to private-sector investment in its contribution to recipient nations. It brings with it capital, training, local job creation, tax



develop in the Third World, too, if the countries that make up the Third World are left to their own devices.

But the Third World lacks time. Its people and its leaders are in a hurry. Which is one reason, as I say, so many opt for the short-sighted shortcut of state controls.

Fortunately, there is a better alternative. Democratic capitalism does not have to be achieved in the Third World from the ground up over centuries as was the case in the West. Democratic capitalism, or many of its vital aspects, can be transplanted in almost turn-key form from places where it already flourishes. The agency of the transplant is the multinational corporation.

To the economically prostrate, administratively chaotic and philosophically adrift Third-World nation seeking to get a grasp on its future, the entry of a multinational corporation is analogous to laying sod on the desert.

Initial benefits are localized. But as the roots sink and the lessons and know-how radiate outward from the transplant, so will the benefits spread. The more transplants made, the more rapid will be the progress.

But like sod, or transplants of any sort, multinational corporations, in order to flourish and spread the benefits

revenues and foreign exchange earnings. In one stroke, the private firm that invests in a developing nation confers benefits it would take decades to generate locally. And these benefits, unlike the aid dollars that seep quickly into the sand, are permanent.

Moreover, direct investment produces secondary and tertiary benefits by supporting local suppliers and satellite industries.

I have seen the transforming effect direct investment can have on the local economy in a developing country, so I am always astonished when I hear companies that make such investments vilified as being exploitative.

### **Biting the Hand...**

Typically, a company comes in, spends millions of dollars to construct a plant, trains a work force, boosts the local economy, and produces a product that previously the host country had to import. Then when it decides to invest a portion of its local earnings elsewhere one hears it charged that the company is being exploitative.

That is ridiculous. The company has done nothing but good. And the reason it has done so is that it has invested

its resources productively. If the host country wishes the profits from those investments reinvested locally, it is up to the host country to ensure that new investments will continue to be equally attractive. That is the way democratic capitalism works. If capital is not free to flow toward the promise of better yield, the system cannot produce the rapid growth and development that is its hallmark. Unfortunately, this is not always appreciated.

Take as an example the multinational pharmaceutical companies. Those firms make the highest quality medicines available in the developing world. And they produce many of them locally. They hire locally and they train the people they hire, providing them skills and know-how they could get nowhere else. In the context of most Third-World economies they are Triple-A economic citizens, a class act.

Yet the pharmaceutical industry is constantly under assault. Once its facilities are in place, developing nations often pursue policies both in their own countries and through such groups as the U.N. Conference on Trade, Aid, and Development, which have the effect of undermining the preconditions for democratic capitalism, and thus of ensuring that future direct investments in their economies will not be made.

International activist groups today are working to have the World Health Organization adopt a regulatory code which would undermine intellectual property rights and impose economic regulation with the aim of redistributing income and assets from the private international firms of the West to the Third-World nations of the South and East.

Such policies are precisely what I was referring to earlier when I described how developing nations drift piecemeal away from the fundamental principles of democratic capitalism and evolve into mongrel economies that defeat their development goals. Developing nations need the sort of growth which only democratic capitalism can provide. But if they are to attain it, they cannot ignore its preconditions.

If you are poor and yearn to be rich, it does not make sense to attack or disadvantage the rich who seek to join with you and share their wealth and their know-how. To do so under the banner of equality is to ensure that you will be neither equal nor rich.

### Alexander the Pauper

The poor are poor because the rich are rich, some argue. They are wrong. They are prisoners of the zero-sum fallacy, the false supposition that the world's supply of wealth is static. Like men squabbling over rations in

a lifeboat, they fixate on the question of distribution. In an open-ended world economy, this is absurd. The world is not a lifeboat; nor is wealth static. Wealth is dynamic and expanding, the rising tide that lifts all boats—redefining, as it rises, the very meaning and objective measures of wealth.

Alexander the Great was rich and powerful. A king, and the son of a king, he conquered much of Asia. No one in his day was richer or more favored by fortune. Yet Alexander was the son of a man crippled and disfigured by injury. He lived in what we would consider filth and ignorance. He ate food the FDA would not approve for a dog. He scratched and shivered like a Bowery bum. And he died of a fever at age 33. In other words, by redefining the meaning of "rich," the world's new wealth has turned Alexander the Great into a pauper. *Most of the "poor" in the developing world today live better and longer than Alexander the Great.*

Equality is a false god. Men lived for millions of years in relatively equal circumstances. But they did it in caves and mud huts and with virtually no disposable income.

If democratic capitalism is associated with the unequal distribution of wealth, it is because democratic capitalism, and the industrial revolution it spawned, *created* most of the world's wealth.

In pre-industrial societies, the king and a few nobles may have sat on piles of gold. But outside the castle moats it was a different story. A chair, a bowl and a hoe were the peasant's dowry. This one might have two bowls, or that one two hoes, but by and large, an equilibrium of poverty prevailed. And one is free to assume, if one wants, that it was a world free of envy and full of bliss.

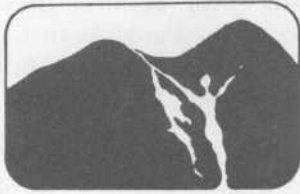
Democratic capitalism changed all that. In a few centuries it heaped upon the citizens of Europe and North America a thousand times the wealth man had known in all prior history. In recent decades it has begun doing the same for dozens of other countries elsewhere in the world—and can continue doing so if permitted.

But by its nature democratic capitalism has heaped more wealth on some individuals and countries than on others. No longer is there an equilibrium of poverty. Instead, there has come to be an inequality of wealth. Is this incredibly fecund new system good because it produced wealth, or bad because it has produced inequality? I'll leave that one to the philosophers. But I will tell you this: if any of you would like to turn back the clock, I can tell you where you can go in the developing world to find people who still live in almost perfect equality. And most of them still have just a bowl and a hoe.



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*Keystone is the seminar setting*

## LEADERSHIP SEMINARS OF THE SHAVANO INSTITUTE: 1985

The Shavano Institute for National Leadership is the center where the principles, ideas, and values embodied at Hillsdale College since 1844 are applied to meet America's leadership needs in the 1980s. The opportunity for American business and other private voluntary institutions to advance human well-being, as argued in the present essay by Lewis Engman, is particularly stressed in Shavano's seminars, TV and radio programs, and publications.

The quality of thinking done by the leaders who gather at Shavano has been shown in recent *Imprimis* papers by Robert Bleiberg on the economic outlook, Gerhart Niemeyer on the Soviet threat, Warren Brookes on technology and religion, Allan Carlson on the loss and recovery of U.S. self-confidence, Tom Wolfe on the moral bankruptcy of Marxism. Each originated as a presentation to several dozen Shavano seminar participants, who held extensive discussions with the speakers and resolved on leadership actions for individuals and the country.

Some 1500 men and women from all walks of life have attended the 30 seminars held by the Shavano Institute for National Leadership since 1982. Many have reported that the experience significantly changed their outlook as American citizens and leaders in these times. George Roche, President of Hillsdale and Shavano, actively guides the leadership seminars; *Imprimis* editor John Andrews serves as program director. You are encouraged to consider attending, or nominating qualified individuals to attend, one of the following 1985 Shavano seminars:

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